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In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1611

HERCOFORM, INC.
PETITIONER

v.

CHICAGO TITLE INSURANCE CO., ET AL,
RESPONDENTS

On Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit

BRIEF FOR CHICAGO TITLE INSURANCE CO. AND NEW ENGLAND MERCHANTS NATIONAL BANK IN OPPOSITION

JOHN W. PHILBRICK, ESQUIRE
VERRILL & DANA
Two Canal Plaza
Portland, ME 04112

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BRIEF FOR THE RESPONDENTS IN OPPOSITION

Proceedings Below

Respondents concur in the description by the Petitioner of the opinions below and the jurisdiction of this Court (Petition, p. 1), but note that the opinion of the First Circuit Court of Appeals is now reported in 568 F.2d 217 (1978).

Question Presented

Whether a federally guaranteed mortgage under the National Housing Act is entitled to priority over a state-created mechanic's lien unrecorded at the time the federal interest arose.

Statement of the Case

The facts of this case have been stipulated by the parties and appear in the Record Appendix to the Court of Appeals for the First Circuit (hereinafter cited as "App."). Because the Petition fails to set forth some important factual material, Respondents would summarize the case as follows:

On September 29, 1971, Petitioner, a subcontractor, entered into a contract with a general contractor to furnish and erect pre-fabricated modular housing units for a moderate income residential housing project. On May 2, 1972, the owner of the property to be developed granted a construction mortgage of its premises to New England Merchants National Bank (hereinafter "Bank"), the mortgage being insured by the Department of Housing and Urban Development (hereinafter "HUD"); both the mortgage and the Regulatory Agreement between HUD and the owner were recorded on that date in the appropriate Registry of Deeds (App., pp. 15, 16, 22-35). Among other indicia of HUD involvement in the transaction, the Regulatory Agreement set forth conditions under which the mortgage could be assigned to HUD after default (App., p. 33).

Over eighteen months after the recordation of the mortgage and Regulatory Agreement, the Petitioner filed a mechanic's lien on December 20, 1973, and simultaneously instituted a civil action to enforce its lien in the State

Court (App., pp. 8, 36-39). Thereafter, as a result of mortgage defaults, the Bank duly assigned its mortgage to HUD in accordance with the Regulatory Agreement (App., p. 19), warranting that the mortgage had priority over all liens or encumbrances (App., p. 40).

Respondent, Chicago Title Insurance Company, insurer of the title to the premises, and the Bank later brought a declaratory judgment action in the United States District Court claiming entitlement to a judgment that Petitioner's lien claim was inferior to the mortgage interest. Petitioner timely appealed the District Court's ruling that the federally insured mortgage was entitled to priority, and has sought a writ of certiorari to review the First Circuit Court's judgment of affirmance.

Reasons for Denying the Writ

A. There Is No Substantial Conflict Among the Circuit Courts

The Court of Appeals, in affirming the District Court judgment declaring the priority of the federal lien, chose not to depart from the rule followed by the clear majority of Federal Court opinions: inchoate state liens cannot prevail over federal liens and mortgages. While recognizing that there had recently been some departure from the formerly unanimous view that the choateness doctrine applied to disputes between a federal non-tax lien and a state-created lien, the Court was understandably unwilling to depart further from a general rule of universal application in order to deal with the vagaries of local perfection requirements of state liens such as mechanic's liens. 568 F.2d at 221.

Petitioner argues (Pet., p. 4) that a "sharp and substantial" conflict exists between seven circuits applying

the choateness doctrine to non-tax federal liens (see cases cited at p. 5, *infra*) and the two circuits which are said to have rejected the doctrine. *See Kimbell Foods, Inc.* v. *Republic National Bank*, 557 F.2d 491 (5th Cir. 1977) *cert. granted*, —— U.S. —— (1978) and *Ault* v. *Harris*, 317 F.Supp. 373 (D. Alaska 1968), *aff'd sub nom. Ault* v. *United States*, 432 F.2d 441 (9th Cir. 1970). An examination of these decisions, viewed against the historical development of the doctrine and the facts of this case, shows that there is no such conflict.

It is firmly established that federal law governs a dispute involving the priority of a federal debt. *See, e.g., United States* v. *Equitable Life Assur. Soc'y*, 384 U.S. 323, 327-328 (1966); *United States* v. *Security Trust & Savings Bank*, 340 U.S. 47, 49 (1950). The federal test is "first in time, first in right." *See, e.g., United States* v. *New Britain*, 347 U.S. 81 (1954); *Rankin* v. *Scott*, 25 U.S. (12 Wheat) 177, 179 (1827). In order to establish which competing lien is "first in time," federal law requires that the state-created lien be "choate" at the time the federal lien attaches. *United States* v. *New Britain, supra*, 347 U.S. at 86. A "choate" lien has been defined as one in which the lienor, the property subject to the lien, and the fixed amount of the lien are firmly established. *United States* v. *New Britain, supra.*

The "choateness" doctrine evolved from the application of 31 U.S.C. § 191, which accorded certain federal priorities in claims against insolvents. This Court held nearly fifty years ago that only "choate" liens would be entitled to priority over federal claims under that statute. *Spokane County* v. *United States*, 279 U.S. 80 (1929). In 1950 this Court extended the choateness concept beyond the insolvency statute and applied it in resolving priorities between a federal tax lien and a state-created lien against property of a solvent debtor. *United States* v. *Security Trust and Savings Bank*, 340 U.S. 47 (1950). In the ensuing twenty-eight years, seven courts of appeals have applied the choateness test to disputes between federal non-tax liens and state liens. *Chicago Title Ins. Co.* v. *Sherred Village Associates*, 568 F.2d 217 (1st Cir. 1978); *United States* v. *General Douglas MacArthur Sr. Village, Inc.*, 470 F.2d 675 (2nd Cir. 1972); *T.H. Rogers Lumber Co.* v. *Apel*, 468 F.2d 14 (10th Cir. 1972); *H.B. Agsten and Sons, Inc.* v. *Huntington Trust and Savings Bank*, 388 F.2d 156 (4th Cir. 1967) (*en banc*), *cert. denied* 390 U.S. 1025 (1968); *United States* v. *Oswald and Hess Co.*, 345 F.2d 886 (3rd Cir. 1965); *United States* v. *County of Iowa*, 295 F.2d 257 (7th Cir. 1961); *United States* v. *Latrobe Construction Co.*, 246 F.2d 357 (8th Cir. 1957), *cert. denied* 355 U.S. 890. Only two circuit court opinions can be viewed as having deviated from this well established rule, and neither case appears to be in conflict with the result reached by the First Circuit in the instant case.

In *Kimbell Foods, Inc.* v. *Republic National Bank*, 557 F.2d 491 (5th Cir. 1977), *cert. granted* U.S. , the Court held that a filing under the Uniform Code was entitled to priority over a subsequent federal mortgage, notwithstanding the fact that the state lien had not been reduced to judgment at the time the federal mortgage arose; however, it specifically excluded from the scope of its decision and rationale any applicability to mechanic's lien cases, such as the one at bar. In much the same manner as Judge Coffin in this case stated the First Circuit's unwillingness to fashion a new and different rule of priority covering varied and parochial methods of perfecting mechanic's liens (568 F.2d at 222), the *Kimbell* Court stated:

> Other types of state liens — for taxes, for mechanics and materialmen, or for certain types of secured loans — present problems that we leave for another day. First, the manner of perfection of those liens is

> diverse — creating havoc with a nationwide program — and may not provide notice sufficient for federal entities to ascertain their existence before granting loans. Second, consideration of these loans for qualification under the federal "first in time, first in right" rule is complicated by the fact that several states, including Texas, either provide special priorities for the liens . . . or allow subsequently perfected liens to relate back to the date the debt was incurred . . . . *Kimbell Foods, Inc.* v. *Republic National Bank,* 557 F.2d at 503, n.15.

The Fifth Circuit, having thus expressly refused to decide the issue presented by this record, cannot be said to be in conflict with the First Circuit.

The Ninth Circuit has addressed this issue only by a *per curiam* affirmance of a district court opinion in *Ault* v. *Harris,* 317 F. Supp. 373 (D. Alaska 1968), *aff'd sub nom Ault* v. *United States,* 432 F.2d 441 (1970). More recently, however, a subsequent decision by Judge Plummer, author of the *Ault* opinion, indicates an intent to limit *Ault* to its facts for reasons fully applicable to this case. *See Thorpe Const. Co.* v. *Irvine and Co.,* 367 F. Supp. 87 (D. Alaska 1973). Just as acceptance of an unusual provision of Alaska lien law would have been necessary to defeat federal priority in *Thorpe,* acceptance of an unusual provision of Maine lien law is necessary to create a "first-in-time" priority in favor of the Petitioner in this case. *Compare Saucier* v. *Maine Supply & Garage Co.,* 109 Me. 342, 84 Atl. 461 (1912) (lien relates back to execution of contract) *with* cases collected in Am. Jur. 2d Mechanics' Liens, §247 (lien relates back to furnishing of first labor materials). Indeed, without both this peculiar provision of Maine law *and* the rejection of the "choateness" doctrine applied in at least seven circuits, the federal interest in this case, which

arose at the recordation of the Regulatory Agreement (*Kimbell Foods, supra,* at 503), would have unquestionable priority over the subsequently recorded lien, in the absence of evidence that construction commenced prior to the Regulatory Agreement.

In summary, the Fifth Circuit's express refusal to decide the issue prescribed by this case and the Ninth Circuit's 1970 *per curiam* affirmance of a case that has been limited to its facts hardly creates a conflict with the opinion below that requires resolution by this Court at this time.

There simply is no "sharp and substantial" conflict among the circuits on the issues presented by this record.

B. The Question Presented By This Record Is a Matter for Congressional, Rather Than Judicial, Resolution

The choateness doctrine, applied by this Court to settle disputes involving federal tax liens and by the lower federal courts to disputes involving federal non-tax liens, represents a rule of federal common law by which priorities between state and federal liens may be easily and predictably decided. Because of its universality of application and consistency of result, the rule can be easily applied in a variety of circumstances. If it is to be modified (or abandoned, as petitioner urges), and a new federal common law rule fashioned by this Court to replace it, the first judicial steps in modifying the "choateness" doctrine should be taken in a case in which any new rule affecting diverse federal interests can be narrow and consistent in its application. If the choateness doctrine applied in seven circuits is to be judicially reexamined, it should be done in a situation such as that presented in *Kimbell Foods, supra,* where the universally adopted Uniform Commercial Code provides a commercially tolerable and broadly recognized

definition of the time when a security interest attaches. In these circumstances, there may exist a rational and finite judicially-created alternative to the choateness doctrine.

Where mechanics' lien claims on projects subject to federal liens are concerned, however, any proposed revision or abandonment of the choateness doctrine should be legislatively investigated. State-created mechanics' liens arise in many different ways and at many different times; there is no uniform rule which can be adopted as federal common law. *See* W. Plumb, *Federal Liens and Priorities — Agenda for the Next Decade II*, 77 Yale L.J. 605, 677 (1968). As noted by the First Circuit (568 F.2d at 221-22), the courts are ill-equipped to determine the impact of adopting a new rule of priority upon such varied factual and legal settings; there is good reason to defer to the Congress the reform, if any is needed, of the rules regulating priorities of federal interests over state-created mechanics liens. Congress has the capacity to hold hearings, seek expert advice, and create policy respecting the priorities of demands on the national treasury. Thus far, against the experience of the decisional law upholding applicability of the choateness doctrine to federal non-tax liens, Congress has acceded to those decisions and has not legislatively altered the result reached by the federal courts. If Congress determines that the result reached by the First Circuit in following settled law ought to be examined, it has the power and resources to investigate and to resolve the complex problems of lien priorities in federally insured housing projects under construction in each of the fifty states. Congress has already acted to reshape priorities between federal tax liens and certain state mechanics liens under very limited circumstances. 1966 Tax Lien Act, 26 USC §6323(b)(7). But until Congress acts, this Court should not intercede in a field where no substantial conflict among

the circuits exists and where the Court does not have the investigative resources to resolve what is essentially a legislative problem of governmental priorities.

Conclusion

Because there is no real conflict among the Circuit Courts of Appeal and because the Congress can best determine the necessity for, and scope of, any changes in the existing law establishing priorities between federal interests and state mechanics' liens, this Court should deny the petition for a writ of certiorari.

Dated: June 1, 1978

Respectfully submitted,

JOHN W. PHILBRICK
Attorney for Respondents
Chicago Title Insurance Co. and
New England Merchants National
Bank

VERRILL & DANA
Two Canal Plaza
Portland, ME 04112
Tel. 207 774-4573